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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Federal Communications Commission
Office of Secretary

In the Matter of)
) CC Docket No. 93-193, Phase I, Part 2
Bell Atlantic 1997 TRP Revisions) CC Docket No. 94-65

BELL ATLANTIC¹ REPLY COMMENTS

Bell Atlantic's revised 1997 filing "corrects" its allocation of sharing among baskets as required by the Commission's order on the 1993-96 tariff investigations.² Nonetheless, AT&T and MCI argue that, rather than correct the allocation of sharing among baskets, the Commission should provide them with a windfall by allocating additional sharing to the Common Line Basket, thereby reducing the indices for that basket, without any reduction to the sharing amount allocated to any other basket.³ Such an adjustment is inconsistent with the Commission's rules and should be rejected.

¹ The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; and Bell Atlantic-West Virginia, Inc.

² The Commission directed Bell Atlantic and Pacific Bell "to correct how they allocate their sharing adjustments among baskets." Memorandum Opinion and Order at ¶ 39 (rel. Apr. 17, 1997) ("1993-96 Access Tariff Order").

³ MCI Comments (filed May 19, 1997); Comments of AT&T Corp. (filed May 19, 1997).

As Bell Atlantic demonstrated in its petition for clarification of the tariff investigation order, the total amount of Bell Atlantic's sharing has never been at issue.⁴ The question before the Commission was the distribution of that agreed upon amount of sharing among the price cap baskets. Indeed, it is ironic that AT&T now makes the argument for a one-sided adjustment. When AT&T brought its petitions against Bell Atlantic's original filings in 1993-96, AT&T was clear that it sought an adjustment to all baskets -- to redistribute sharing, not to increase it.⁵

There is no substance to MCI's argument that an order requiring Bell Atlantic to correct *all* the price cap indices would constitute impermissible "retroactive ratemaking."⁶ The rule against retroactive ratemaking -- which derives from the "filed rate doctrine"⁷ -- does not prohibit the adjustments at issue here because the orders suspending each of Bell Atlantic's annual access tariff filings gave notice to Bell Atlantic's access customers that, after investigation, the allocation of sharing amounts to each price cap basket might have to be adjusted. The 1993 Order addressed the complaint by AT&T that sharing was improperly distributed among *all* the baskets. MCI and other carriers were put on notice through the Common Carrier Bureau's discussion of the issues and its conclusion that "there is sufficient uncertainty to warrant investigation of Bell Atlantic's PCI

⁴ Bell Atlantic Petition for Clarification (filed May 19, 1997). For the convenience of the Commission, because many of the arguments raised by commenters here are already addressed in Bell Atlantic's petition, Bell Atlantic does not repeat its justification, but rather incorporates the petition and attached it here as Attachment 1.

⁵ See Exhibit 2 of Bell Atlantic Petition for Clarification.

⁶ MCI Comments at 6.

⁷ See *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577-78 (1981); *Columbia Gas Transmission Corp. v. FERC*, 831 F.2d 1135, 1140-41 (D.C. Cir. 1987).

adjustments.”⁸ Not just the single adjustment to the Common Line Basket, but the multiple adjustments to the other baskets as well.⁹

-- Where, as here, the Commission provides adequate notice that rates are subject to investigation and an accounting order, “it changes what would be purely retroactive ratemaking into a functionally prospective process by placing the relevant audience on notice at the outset that the rates being promulgated are provisional only and subject to later revision.”¹⁰ Because MCI and the other carriers knew at the time that the indices were subject to correction, they have no basis to complain now that they relied on the finality of affected rates.¹¹

Both AT&T and MCI also complain that Bell Atlantic should have restated its permanent price cap indices to reflect the changes to the sharing distribution.¹² But such a requirement would

⁸ **1993 Annual Access Tariff Filings**, Memorandum Opinion and Order, 8 FCC Rcd. 4960, 4966 (Com. Car. Bur. 1993).

⁹ The investigation orders in subsequent years adopted the scope of the original investigation and made those rates subject to that investigation. **1994 Annual Access Filings**, Memorandum Opinion and Order, 9 FCC Rcd. 3705, 3715 (1994); **1995 Annual Access Filings**, Memorandum Opinion and Order, 11 FCC Rcd 5461, 5488 (1995); **1996 Annual Access Filings**, Memorandum Opinion and Order, 11 FCC Rcd 7564, 7580 (1996). Moreover, each order made reference to renewed complaints by AT&T, which clearly contemplated that there would be a correction to all baskets. *Id.* See also, Exhibit 2 of Bell Atlantic Petition for Clarification.

¹⁰ **Columbia Gas Transmission Corp. v. FERC**, 895 F.2d 791, 797 (D.C. Cir.), *cert. denied*, 498 U.S. 907 (1990).

¹¹ If the Commission nevertheless finds that it lacks authority to make the correction it has ordered, the solution is not to mandate an adjustment only to one basket, but to refrain from imposing additional requirements. A one-sided adjustment would not “correct” anything. Instead, it would dramatically increase the total sharing obligation. See Exhibit 3 of Bell Atlantic Petition for Clarification. It is far more benign to leave current indices unchanged. The sharing distribution for the years under review has no impact on current indices because any sharing adjustments were reversed the following year. Moreover, Bell Atlantic indisputably shared the correct amount on a timely basis. It would be improper for the Commission to “solve” a dispute over sharing *distribution* by increasing the total amount shared.

¹² MCI Comments at 4; Comments of AT&T Corp. at 4-5.

be inconsistent with the Commission's rules on sharing.¹³ Sharing is a one-time event that is removed after one year. To restate the indices would be a pointless exercise. For every year in which indices are adjusted to reflect a sharing obligation, the indices must be readjusted to remove that sharing amount for the following year. Moreover, because of frequent interim adjustments to their price cap indices, such a requirement would be extremely burdensome for baskets other than the Common Line Basket.¹⁴ In its filing, Bell Atlantic directly calculated the sharing adjustment by comparing the sharing total for each year for each basket under Bell Atlantic's original calculation with the sharing amounts under the methodology mandated in the 1993-96 Access Order.¹⁵ Such a direct calculation fully complies with the Commission's directive that Bell Atlantic's adjustments reflect the impact of the corrected methodology.

¹³ See Affidavit of William E. Taylor at ¶ 22, attached as Exhibit 1 to Bell Atlantic Petition for Clarification.

¹⁴ Bell Atlantic is able to recalculate indices for the Common Line Basket because, unlike the other baskets, Common Line does not require any calculation of actual price indices or sub-basket indices.

¹⁵ Bell Atlantic Submission of Revised Tariff Review Plan, Workpapers S-1 through S-4-1 (filed May 8, 1997). Using a restatement of indices will not produce significantly different results. Attached as Attachment 2 is a restatement of Bell Atlantic's Common Line Basket Index with the adjustment to the sharing distribution. Not only is the difference (\$2.4M) less than two percent of the total sharing amount, it also provides for a *smaller* adjustment to the Common Line Basket than does Bell Atlantic's more direct calculation.

Conclusion

-- The Commission should grant Bell Atlantic's petition, clarify that the sharing allocation should be corrected for all price cap baskets, and let Bell Atlantic's index adjustments stand as filed.

Respectfully submitted,

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May 27, 1997

Bell Atlantic Reply Comments

ATTACHMENT 1

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In the Matter of
1993 Annual Access Tariff Filings

GSF Order Compliance Filings

In the Matter of
1994 Annual Access Tariff Filings

In the Matter of
1995 Annual Access Tariff Filings

In the Matter of
1996 Annual Access Tariff Filings

Docket No. 93-193, Phase I, Part 2

CC Docket No. 94-65

BELL ATLANTIC PETITION FOR CLARIFICATION

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FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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BELL ATLANTIC¹ PETITION FOR CLARIFICATION

Summary and Introduction

In its recent order, the Commission found that Bell Atlantic and Pacific Bell incorrectly distributed their sharing obligation among the price cap baskets during the 1993-96 tariff years, and, by doing so, assigned too small a portion of the obligation to the common line basket. As a result, it directed those companies "to correct how they allocate their sharing adjustments among baskets."² The specific directions provided later in the order, however, address only one part of the calculation that is necessary to fully "correct" the allocation of sharing among the baskets.

¹ The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; and Bell Atlantic-West Virginia, Inc.

² Memorandum Opinion and Order at ¶ 39 (rel. Apr. 17, 1997) ("1993-96 Access Tariff Order").

Specifically, while the order outlines the procedure to reallocate sharing *to* the common line basket and thereby reduce the price cap indices for that basket, it does not address the corresponding procedure to reallocate sharing *from* other baskets and thereby increase the price cap indices for those baskets. But performing only one-half of the required calculation would not correct the previous allocation that the Commission has now concluded was incorrect, and by requiring Bell Atlantic to share more than is required by its rules would also be inconsistent with the Commission's own price cap regulations. Consequently, Bell Atlantic respectfully requests that the Commission clarify that both parts of the calculation are required in order to implement its recent order.

I. Bell Atlantic's Methodology

During the years at issue here, the Commission's rules required Bell Atlantic and other local exchange carriers ("LECs") subject to price caps to calculate a single sharing number annually based on 50 percent of the total regulated interstate earnings above 12.25 percent. Nothing in the Commission's order here questions the accuracy of Bell Atlantic's calculation of its total sharing obligation in each of the years under review, nor did any party challenge those calculations as part of their complaints here. By the same token, there is no dispute that the full amount of these sharing obligations already have been distributed to customers in the form of one-time adjustments to Bell Atlantic's price cap indices.

Rather, the sole issue in this proceeding is the method used to distribute those sharing amounts among the various price cap baskets. The Commission's price cap regulations require that a sharing adjustment be made in the same manner as exogenous changes.³ This means that

³ *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, 6801 (1990) ("Price Cap Order").

the allocation of sharing among the price cap baskets must be on a "cost-causative" basis.⁴ In its order addressing the 1992 access tariffs, the Common Carrier Bureau directed that this allocation be performed using the total revenues in each of the various baskets as a proxy for cost.⁵ Those carriers that had not allocated their sharing obligations based upon the revenues in each of the baskets were required to revise their filings. Significantly, the Bureau specifically recognized that the impact of its decision would be to lower rates in some baskets and to raise rates in others.⁶

Consistent with this order, Bell Atlantic's 1993 annual tariff filing did allocate its sharing obligation among baskets based upon the revenues in those baskets. In performing its calculations, however, Bell Atlantic excluded end-user Common Line revenues (subscriber line charge or "SLC") from the amount of revenue assigned to the common line basket. These revenues were excluded in order to comply with Bell Atlantic's understanding of the cost causation principles applied by the Commission. Specifically, SLC revenues are based solely on a forecasted revenue requirement, and not on price cap indices or productivity adjustments.⁷ Because the SLCs are capped and the revenue requirement is set to meet the 11.25% earnings benchmark, SLCs cannot contribute to earnings above that benchmark, and so do not "cause" any earnings above the even higher threshold that give rise to sharing obligations.⁸ Because the SLC

⁴ 47 C.F.R. § 61.45(d)(4).

⁵ *1992 Annual Access Filings*, 7 FCC Rcd 4731, 4732-33 (Com. Car. Bur. 1992) ("1992 Access Order"). In that order, the Bureau rejected an allocation based on basket earnings.

⁶ *Id.* at 4734.

⁷ *See* 47 C.F.R. § 61.38.

⁸ *See* Affidavit of William E. Taylor at ¶¶ 8-11, attached as Exhibit 1 ("Taylor Affidavit").

revenues in no sense cause a sharing obligation to be incurred, it was Bell Atlantic's understanding that they should properly be excluded when allocating any sharing obligation among baskets.

II. The Complaint And Investigation

AT&T objected to Bell Atlantic's exclusion of SLC revenues in its allocation of sharing obligations among the various price cap baskets. According to AT&T, excluding these revenues "overstated the sharing amounts, and understated the access rates, for Bell Atlantic's other baskets."⁹ AT&T proposed its own "corrected" allocations that increased the amount of the sharing obligation that was allocated to the Common Line Basket and decreased the amount allocated to the other baskets.¹⁰

In response to AT&T's complaint, the Bureau found that it was "not clear" that Bell Atlantic's exclusion of SLC revenues was consistent with prior Commission orders.¹¹ It concluded that there was "sufficient uncertainty to warrant investigation."¹² As a result, the Bureau suspended Bell Atlantic's rates for one day, and then allowed them to go into effect subject to an investigation and accounting order.

The investigation continued through the period in which Bell Atlantic was required to file its annual access tariffs in 1994, 1995 and 1996. Consistent with the approach taken in its 1993 filing, Bell Atlantic again excluded SLC revenues from its calculations to allocate its sharing

⁹ *1993 Annual Access Tariff Filings*, AT&T Opposition to Bell Atlantic Direct Cases at 28 (filed Aug. 24, 1993).

¹⁰ *Id.*

¹¹ *1993 Annual Access Tariff Filings*, CC Docket No. 93-193, Memorandum Opinion and Order, 8 FCC Red 4960, 4966 (Com Car. Bur. 1993).

¹² *Id.*

obligations among baskets. AT&T objected to each of these filings.¹³ In each instance, AT&T recalculated the sharing amounts allocated to each basket to reflect an upward adjustment in the amount allocated to the Common Line Basket and a downward adjustment in the amount allocated to the three remaining baskets.¹⁴

As it had with 1993 tariff filing, the Commission responded to each of AT&T's complaints by folding the issue of how the sharing was distributed for each of the subsequent years into the existing 1993 investigation.¹⁵

Nowhere in the record for all four years was there ever a suggestion -- by AT&T, the Commission, or any other party -- that Bell Atlantic did not share the correct amount. Both Bell Atlantic and AT&T were clear that the issue before the Commission was a question of how the given amount of total sharing should be distributed among the baskets, not how to determine the total amount to be shared in the first instance.

¹³ In 1994 and 1996, AT&T's complaint concerning the allocation of sharing was joined by one other party. In each instance, the additional party merely referenced the existing investigation concerning the allocation of sharing among baskets. Neither of these additional parties ever suggested that the resolution of their complaint would involve an increase in the total amount shared. *1994 Annual Access Tariff Filings*, Allnet Communication Services, Inc. Petition To Suspend For One Day and Investigate (filed Apr. 26, 1994); *1996 Annual Access Filings*, Sprint Communications Co. Petition to Reject or Alternatively Suspend and Investigate (filed Apr. 29, 1996).

¹⁴ Attached as Exhibit 2 is AT&T's calculations excerpted from each of these filings.

¹⁵ *1994 Annual Access Filings*, Memorandum Opinion & Order, 9 FCC Red 3705, 3715 (1994); *1995 Annual Access Filings*, Memorandum Opinion & Order, 11 FCC Red 5461, 5488-89 (1995); *1996 Annual Access Filings*, Memorandum Opinion & Order, 11 FCC Red 7564, 7580 (1996).

III. The Commission's Order

In its recent order, the Commission found that Bell Atlantic and Pacific "incorrectly allocated their sharing obligations among the various service baskets."¹⁶ The 1993-96 order does not require that Bell Atlantic recalculate its total sharing obligation (nor could it since the issue was never raised). Instead, the order requires Bell Atlantic to "correct" the manner in which it allocated its sharing obligation "among baskets."

The Commission's order is unclear in two respects. First, despite the clear requirement that Bell Atlantic must reallocate sharing "among" the baskets, and not limit its adjustment to any one basket, the more specific instructions set out at the end of the order speak only of how to "implement refunds."¹⁷ Consequently, to remove any doubt about what was intended, the Commission should clarify that the order is intended to fix the distribution of sharing to all baskets -- not to increase the total amount shared by limiting the adjustment to the one basket that has increased sharing.

Specifically, the Commission's order directed Bell Atlantic and Pacific "to correct how they allocate their sharing adjustments among the baskets."¹⁸ To truly "correct" the allocation of sharing, however, the indices for all of the baskets must be recalculated to reflect the allocation method in the Commission's order. In contrast, making only the downward adjustment to the indices for the Common Line basket -- and ignoring the corresponding upward adjustments to

¹⁶ 1993-96 Access Tariff Order at ¶ 39.

¹⁷ *Id.* See also *Id.* at Section V.

¹⁸ *Id.* at ¶ 39.

the other baskets -- would not "correct" how Bell Atlantic allocated its sharing adjustment among the baskets.

Second, the detailed instructions in Section V of the order should be clarified in a number of technical respects. First, those instructions require carriers to adjust their permanent price cap indices. But that is inconsistent with the Commission's own price cap rules, which treat sharing as a one-time event that must not have an impact beyond a single year. A reduction in the price cap index to reflect the sharing obligation for a given year is raised back up the following year, and is never embedded in the permanent price cap index.¹⁹ Second, the instructions require carriers to recalculate their indices "at the beginning and middle of each tariff year."²⁰ But relying on those checkpoints would skip any tariff filings made in the interim and distort the results.²¹ Finally, the Commission should correct an apparent typographical error that confuses the instructions.²²

IV. A Partial Correction Would Be Inconsistent With the Commission's Own Price Cap Rules

Were the Commission to interpret the 1993-96 Order as requiring an adjustment only to the common line basket, Bell Atlantic would be required to increase the amount shared in that

¹⁹ See Taylor Affidavit at ¶ 20. After consulting with Commission staff on this issue, Bell Atlantic calculated the impact of the reallocation of its sharing obligation outside of the price cap models and made a one-time adjustment to the indices to incorporate that result.

²⁰ 1993-96 Access Tariff Order, ¶ 98.

²¹ See *1993, 1994, 1995, 1996 Annual Tariff Filings*, Bell Atlantic's Revised Tariff Review Plan for Compliance with Commission's Memorandum Opinion & Order, FCC 97-139, (filed May 8, 1997).

²² See 1993-96 Access Tariff Order, ¶ 105 step 3. Instead of "ratio of revenue in 1993, the last year of this investigation, to the base year revenue," the text should read: "ratio of revenue in 1997, the last year of this investigation, to the base year revenue."

basket without the corresponding reductions in the amount shared for the other baskets. Despite the fact that the total sharing amount was never in dispute, this would have the effect of increasing the total amount of Bell Atlantic's sharing for the years in question.

Such a requirement would not only serve as a penalty on Bell Atlantic, but it would also provide a windfall to Bell Atlantic's large access customers. These customers purchase services from each of the price cap baskets. As a result, they have already benefited when Bell Atlantic shared the first time. To require Bell Atlantic to share a second time by requiring a recalculation only of the amount of sharing allocated to the Common Line Basket would allow these customers to collect twice.

While the Commission has the right to order a refund for a rate that was under timely investigation and found to be unlawful, such a refund must be consistent with the Commission's then existing rules and regulations. A refund that would "contradict the Commission's own theory" of regulation is unlawful.²³ Here, an order that increases the amount of Bell Atlantic's sharing for the years under investigation would be inconsistent with the Commission's price cap regulations in at least four respects.²⁴

First, the sharing plan has a "50-50 sharing zone" wherein LECs complying with price cap regulation will be required to share with consumers 50 percent of their earnings between

²³ *AT&T v. FCC*, 836 F.2d 1386, 1392-93 (D.C. Cir. 1988). While the Commission has the ability to change its policy, it must "supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored." *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970), *cert. denied* 403 U.S. 923 (1971). Given that the Commission has recently reaffirmed the policies underlying its price cap regulation, it cannot ignore those policies here.

²⁴ *See also* Taylor Affidavit at ¶¶ 13-20.

12.25 percent and . . . 16.25 percent.”²⁵ If the redistribution were only made to the Common Line Basket, the amount that Bell Atlantic was required to share would increase to a point well above 50% of its earnings within the sharing range -- more than a 27% increase in sharing for the most recent year under review.²⁶

Second, the sharing mechanism “operates only as a one-time adjustment to a single year’s rates, so a LEC would not risk affecting future earnings.”²⁷ Bell Atlantic distributed the full amount of its sharing obligation for the years in questions. Any requirement that Bell Atlantic refund additional sharing dollars without an offsetting adjustment to other baskets means that Bell Atlantic would be obliged to share a second time for past years’ earnings. Its 1997 earnings would be reduced as a result, yet the Commission made no finding that the calculation of Bell Atlantic’s total sharing obligation was incorrect.

Third, the sharing mechanism “is created as a backstop to the [price cap] plan as a whole, not to individual rates or even basket earnings levels.”²⁸ “The plan stresses LEC overall productivity, and the sharing mechanism is keyed to that unified approach.”²⁹ If the Commission were to require a redistribution to one basket, but not to others, Bell Atlantic would have different sharing requirements for different baskets in violation of this principle.

²⁵ Price Cap Order at 6801.

²⁶ Attached as Exhibit 3 is a Workpaper that calculates the percentage of earnings that Bell Atlantic would be required to share if it were required to correct the allocation of sharing only to the Common Line Basket.

²⁷ Price Cap Order at 6803.

²⁸ *Policy and Rules Concerning Rates for Dominant Carriers*, Order on Reconsideration, 6 FCC Red. 2637, 2679 (1991) (“Price Cap Reconsideration Order”).

²⁹ *Id.*

Finally, changes in the price cap levels are to be based on exogenous costs changes, inflation or expected productivity growth.³⁰ Indeed, the Commission has recently announced a large increase in the price cap productivity factor, and even required all current indices to be adjusted to reflect revised productivity calculations for last year.³¹ This change will have the impact of significantly reducing access rates. It would be inconsistent with price cap regulation in general, and the Commission's price cap reform decision in particular, to now require a significant *additional* reduction based on prior years' sharing obligations when all parties must concede that the correct sharing amount was distributed in full in a timely fashion.³²

³⁰ See 47 C.F.R. § 61.45.

³¹ *FCC News Release* "Commission Reforms Its Price Cap Plan," Report No. CC 97-22 (rel. May 7, 1997).


³² See Taylor Affidavit at ¶¶ 14-15.

Conclusion

For all the foregoing reasons, Bell Atlantic respectfully requests that the Commission clarify that Bell Atlantic should correct the allocation of its sharing obligations by making a temporary adjustment to the indices in each of its baskets to reflect the requirements of the Commission's recent order governing the allocation of sharing.

Respectfully submitted,

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EXHIBIT 1

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In the Matter of)	
1996 Annual Access Tariff Filings)	

AFFIDAVIT OF WILLIAM E. TAYLOR

1. I am Senior Vice President of National Economic Research Associates, Inc. (NERA), head of its telecommunications economics practice and head of its Cambridge office. My business address is One Main Street, Cambridge, Massachusetts 02142.

2. I have been an economist for over twenty-five years. I received a B.A. degree in economics (Magna Cum Laude) from Harvard College in 1968, a master's degree in statistics from the University of California at Berkeley in 1970, and a Ph.D. in Economics from Berkeley in 1974, specializing in industrial organization and econometrics. I have taught and published research in the areas of microeconomics, theoretical and applied econometrics, and telecommunications policy at academic institutions (including the economics departments of Cornell University, the Catholic University of Louvain in Belgium, and the Massachusetts

Institute of Technology) and at research organizations in the telecommunications industry (including Bell Laboratories and Bell Communications Research, Inc.). I have participated in telecommunications regulatory proceedings before state public service commissions and the Federal Communications Commission ("FCC") concerning competition, incentive regulation, price cap regulation, productivity, access charges, pricing for economic efficiency, and cost allocation methods for joint supply of video, voice and data services on broadband networks. A copy of my vita was provided as an attachment to my affidavit filed on behalf of Bell Atlantic and other parties in CC Docket No. 96-46 on April 26, 1996.

I. BACKGROUND AND SUMMARY

3. In its Memorandum Opinion and Order in CC Docket Nos. 93-193 and 94-65,¹ the FCC resolved most of its open investigations of price cap issues arising in the four annual access filings that have occurred since 1993. Among other things, the *1993-96 Access Tariff Order* found that Bell Atlantic allocated its earnings sharing adjustment to its price cap baskets incorrectly. The price cap rules specify that the customer share (including interest) is to be refunded through a one-time reduction in the PCI for the next rate period, calculated in the same manner as other exogenous changes.² Section 61.45(d)(4) of the Commission's Rules specifies that exogenous changes should be allocated among the four price cap baskets on a "cost-causative" basis. The *1993-96 Access Tariff Order* found that Bell Atlantic's allocation—based on revenue from carrier access services (omitting subscriber line revenue)—was incorrect in its annual filings for 1993 through 1996. As a result, the *1993-96 Access Tariff Order* directs Bell Atlantic to correct its allocation, revise its indices and implement refunds so that its pricing limits

¹In the Matter of 1993 Annual Access Tariff Filings, GSF Order Compliance Filings, 1994 Annual Access Tariff Filings, 1995 Annual Access Tariff Filings, 1996 Annual Access Tariff Filings, *Memorandum Opinion and Order*, CC Docket Nos. 93-193 (Phase I, Part 2) and 94-65, released April 17, 1997 (the "1993-96 Access Tariff Order").

²Policy and Rules Concerning Rates for Dominant Carriers, *Second Report and Order* 5 FCC Rcd at 6801 (1990) ("LEC Price Cap Order").

reflect the corrected allocation and overcharges relative to those limits are refunded to customers.³ The specific adjustments outlined in the Order, however, do not accomplish these goals.

4. From an economic perspective, Bell Atlantic's method of allocating its sharing adjustment among baskets in its 1993 to 1996 tariffs was reasonable and returned the proper sharing amount—half its earnings between 12.25 and 16.25 percent—to its interstate customers. In addition, Bell Atlantic's allocation method appears to have been consistent with the Commission's *1992 Annual Access Order* because it allocated adjustments to price limits proportionally across services on a cost causative basis, rather than targeting reductions to services according to productivity growth or other criteria. The Commission has concluded, however, that Bell Atlantic's allocation method was wrong and should be corrected. The purpose of this affidavit is not to second guess that conclusion. Rather, this affidavit explains from an economic standpoint, the proper way to correct the sharing allocation to comply with the Commission's order in order to ensure that the correct amount is shared with interstate customers and the efficiency incentives established in the price cap plan are preserved.

5. As I explain below, implementing the *1993-96 Access Tariff Order* should entail no aggregate refund obligation for Bell Atlantic because interstate customers, in total, already received precisely the earnings sharing adjustment to which they were entitled. The *1993-96 Access Tariff Order*, however, sets out a method for calculating a refund liability for baskets that received too little sharing adjustment; but does not specify how to calculate the offsetting effect for the baskets that received too much. If the order were interpreted—incorrectly from an economic perspective—to mean that Bell Atlantic should incur a liability for its incorrect under-allocation of the earnings sharing adjustment to the common line basket but not offset that liability with the incorrect over-allocation of the earnings sharing adjustment to the three other price cap baskets, such an interpretation would be inconsistent with the Commission's price cap

³ *1993-96 Access Tariff Order*, ¶ 39. Two adjustments are required to Bell Atlantic's PCIs, SBIs and maximum CCL rate: (i) a permanent adjustment to correct its PCIs (and other pricing limits) "so that those PCIs are what would have been in place had they been calculated consistent with the Commission's rules and decisions" [*1993-96 Access Tariff Order* at ¶ 97] and (ii) a one-time adjustment to "refund to [its] customers all amounts, plus interest, collected as a result of overcharges." [*1993-96 Access Tariff Order* at ¶ 104]

rules since it would require Bell Atlantic to share more in total than is required, and would represent bad economic policy. The economic consequence would be bad for customers because changes in the price cap rules after the fact would undercut the incentives the regulated firm has under price caps to lower costs, expand demand and (generally) to increase productivity growth. It would also mean that some customers would receive an unwarranted windfall since the correct amount has already been shared with customers.

II. BELL ATLANTIC'S PREVIOUS ALLOCATION WAS CONSISTENT WITH THE ECONOMIC PRINCIPLES UNDERLYING THE COMMISSION'S 1992 ACCESS TARIFF ORDER AND RETURNED THE CORRECT SHARING AMOUNT TO CUSTOMERS.

6. In 1990, the FCC adopted a price cap plan for the regulation of the interstate services of local exchange carriers. The plan identified four baskets of services (common line, traffic sensitive, special access and interexchange) and adjusted four price cap indices independently (one for each basket) using a formula that combined national inflation, a single productivity offset (X) and adjustments for exogenous changes in costs.⁴ By replacing traditional rate of return regulation with price cap regulation, the Commission sought to correct the incentives under which regulated local exchange carriers operated, essentially breaking the link between accounting costs and service prices. At the same time, the Commission instituted an earnings sharing and backstop mechanism to mitigate the efficiency losses from possible differences in prices and costs and to introduce a self-correcting mechanism into the plan.

7. The earnings sharing and backstop mechanism was triggered by earnings for the aggregate of all interstate services in all four price cap baskets. Over-earnings were returned by a one-time (one year) reduction in the PCI for each basket, where the sharing amount was to be allocated to each basket on a "cost-causative" basis, in the same manner as other exogenous cost changes were allocated to baskets. For general exogenous cost changes, the economic intent of this requirement was to tie as tightly as possible exogenous changes in costs for a service to

⁴ The plan also identified service categories and subcategories within baskets whose price changes were limited by upper and lower price bands around a subindex of prices called the Service Band Index ("SBI") which moved with the PCI change for each basket.

changes in price for that service, so that, for each service, prices and exogenous costs would move together. Similarly, for the special case of sharing, assignment of the total amount to each basket on a cost-causative basis is also desirable because it tends to move service prices in each basket as costs change in that basket.

8. In its *1992 Access Tariff Order*, the Commission determined that revenues in each basket could be used as a proxy for costs in each basket: "because rates are set based on costs, revenue should equal costs." From this reasonable approximation, the Order concluded that, because revenues in each basket approximately equal costs in each basket, allocating exogenous cost adjustments to the baskets by revenue was, in effect, an allocation on a cost-causal basis.⁵ Because price limits for the different baskets will generally move in proportion to the change in costs, such an allocation broadly comports with the economist's notion of a cost-causal allocation.

9. While this method is generally correct, the common line basket requires special treatment under the assumptions of the *1992 Annual Access Order* in order that a revenue-based allocation achieve a cost-causative result. The issue here is different from that addressed in the *1992 Annual Access Order*. In that Order, the Commission declined to allow price cap LECs to target sharing allocations to baskets depending on the degree to which services in the basket contributed more or less to the productivity growth that led to the earnings sharing adjustment. The Commission determined that productivity growth in all interstate services is responsible for an aggregate earnings sharing requirement and therefore that all interstate services should benefit proportionately from the sharing adjustment.⁶ Given, then, that the objective of the allocation method is to reduce price ceilings for all interstate services in the same proportion, the common line basket requires special treatment if sharing amounts are to be allocated correctly from an economic standpoint.

⁵ *1992 Annual Access Order*, 7 FCC Rcd at 4733. As the Common Carrier Bureau noted, "allocating sharing and low end adjustments on the basis of relative basket revenues most closely comports with the goals of the Commission's price cap plan" and that such an allocation is consistent with the requirement that the sharing obligation be calculated on the basis of total interstate earnings: *1992 Annual Access Order*, 7 FCC Rcd at 4732-33.

⁶ *Ibid.*